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ANNUAL REPORT

Red Owl Stores, Inc. • Period ended February 25, 1956

AN ATTRACTIVE SETTING invites shoppers into this new Red Owl store, recently opened in Appleton, Wisconsin. Interior plan of the same store is shown on page 4 of this report.



To our Stockholders and Employees

It is gratifying to be able to render this report of the Company's 34th year of operation—a year of progress. New records were established in sales and earnings. Stores opened were substantially the same as expansion plans announced for the period.

Sales, by far the largest in the history of the Company, were \$123,753,056, an increase of more than 10% over the previous year. Average retail sales per location climbed materially, reflecting the Company's continuing transition from small stores to supermarkets.

We are pleased to report that net earnings, too, reached a new high of \$1,219,625 compared with \$983,882, before special items, reported for the preceding year. It is evident that management's course adopted in the past of building sales and aggressively opening new retail outlets has had the anticipated effect on the earnings of the Company. Based on shares outstanding at the year-end, net earnings after preferred dividends were equivalent to \$2.17 per share of common stock compared with \$1.95 a year ago.

Shareholders received an aggregate of \$709,678 on their investment in the Company. Four quarterly dividends of 30 cents per share were paid on the common stock, thereby resulting in an increase from \$1.05 total per share paid in the prior year to a total of \$1.20 in the period covered by this report. Dividend requirements on the preferred series were paid on due dates.

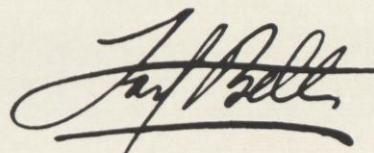
The accompanying financial statements reveal a favorable financial position at the year-end and disclose that capital has been made available to assure the continuance of our expansion program.

Fourteen new stores were opened within the fiscal year while five additional units initially contemplated as part of the year's program, but not entirely complete by the year-end, opened shortly thereafter in March, 1956. Present plans for the year ahead provide for developing approximately twenty additional supermarkets. These expansion sights, we believe, reflect clearly the confidence your management has in Red Owl's future. Emphasis will be directed toward increasing profits by means of expense control and effective merchandising methods.

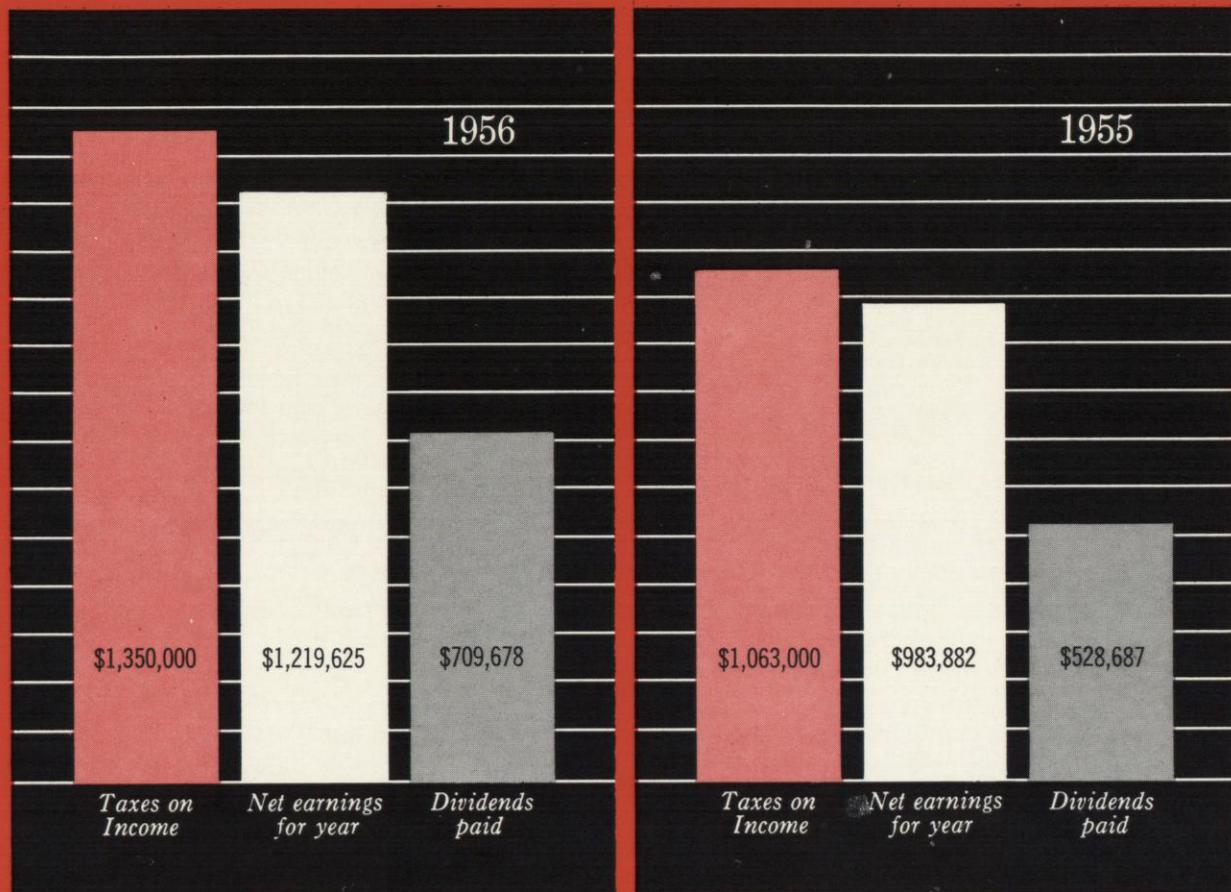
On March 9, 1956 the Board of Directors announced two changes in the top management of the Company. The undersigned was elected Chairman of the Board of Directors, a newly created post, and Mr. Glenn R. Grife, formerly Executive Vice President, was elected President of the Company. Under the new arrangement, the Chairman of the Board will be the chief executive officer of the corporation with responsibility for its over-all direction. It is anticipated that this will provide a broader organizational foundation for the planned growth of the Company.

Revolutionary changes have occurred in the industry during recent years. Supermarket operations have resulted in vastly improved methods of distribution and merchandising. Red Owl's aim always is to keep abreast of new trends and efficiencies to bring better quality products to the consumer at fair prices.

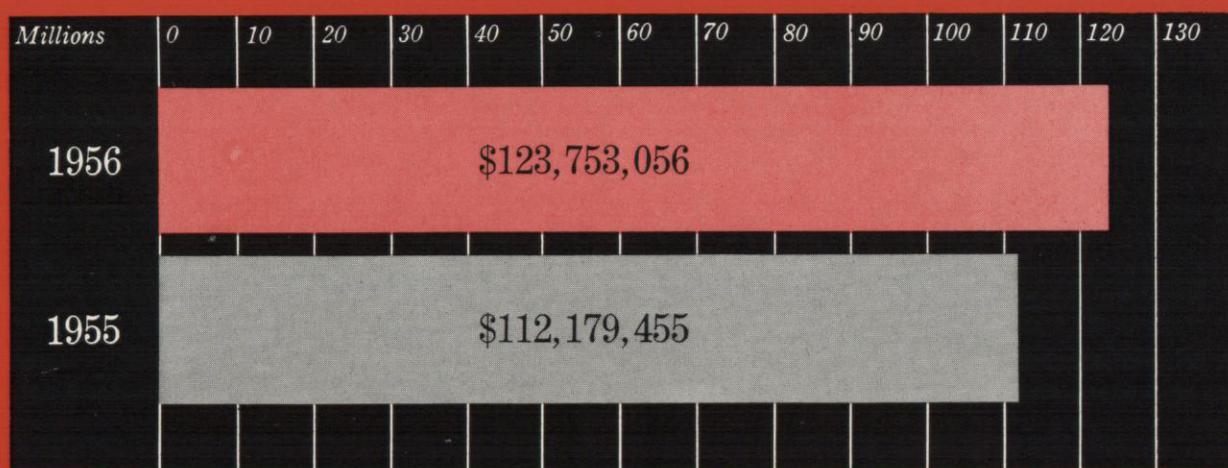
We are grateful for the co-operation and support of the stockholders and employees in the year just past and know that such progress could not have been achieved without your continued faith and loyalty. Although we are well aware of the challenges that lie ahead, we are confident that with your support the Company will continue to grow, much to the benefit of you—our stockholders and employees.



Comparison of taxes on income, net earnings and dividends



Total sales comparison





Review of the Year's Operations

Sales

Sales of goods and services for the fiscal year ended February 25, 1956 increased approximately 10% over the previous year, establishing a new record of \$123,753,056. Retail sales amounted to \$95,073,867, an increase of more than 17%, due to the aggressive supermarket expansion program. During the year the management initiated a consolidation program designed to permit better utilization of facilities and intended to develop a greater return on investment. Various wholesale produce and grocery accounts were discontinued, and a wholly-owned fruit and vegetable subsidiary was dissolved and its operations and net assets absorbed by the parent Company on December 31, 1955. These changes accounted for a wholesale volume decline but resulted in improved operations.

The practice of giving trading stamps with food purchases has become quite general in this operating area. Surveys conducted by the Company disclosed consumer acceptance of trading stamps to such an extent that by the close of the year the majority of Red Owl stores were giving stamps redeemable for premium merchandise.

Earnings

Pre-tax earnings (excluding Hopkins Realty Company, a wholly-owned real estate subsidiary) were the largest in the history of the Company, amounting to \$2,569,625 compared with \$2,046,882 the prior fiscal year. Net earnings after taxes on income were \$1,219,625 equivalent to 99/100 cents per dollar of sales, against \$983,882, before special items, or 88/100 cents per dollar of sales the previous year. The initial costs of opening a larger number of new stores became a greater charge against earnings in the current year.

Computed on the basis of the number of shares outstanding at the close of the year, net earnings per share of common stock, after preferred dividend payments, were \$2.17 compared with \$1.95 the preceding year. This gain in earnings per share common would have been greater had it not been for a substantial increase in preferred dividend requirements of preferred shares outstanding the entire year, and the effect of issuing an additional 30,750 common shares as a result of preferred stock conversions.

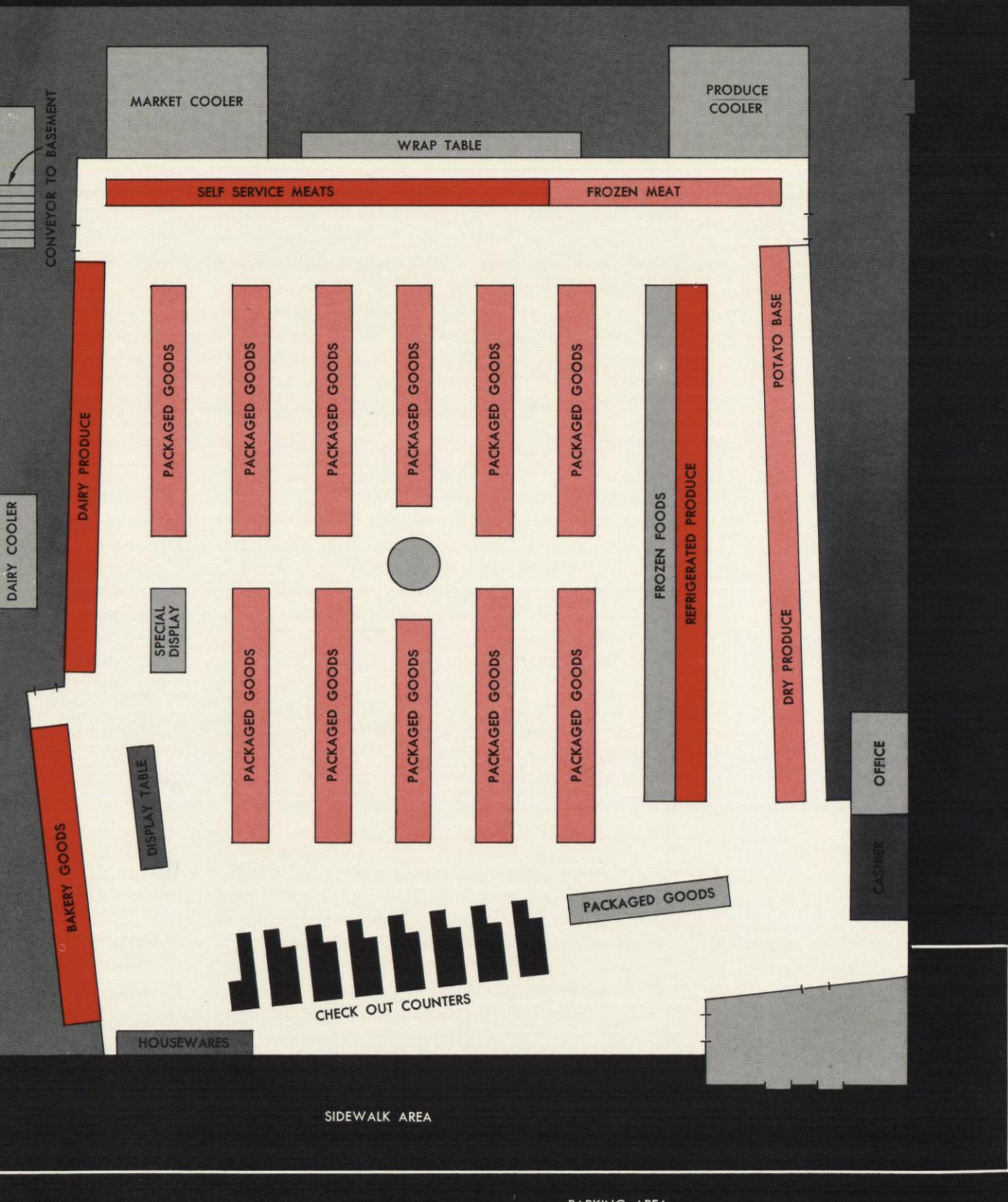
Dividends

Dividends paid on the common stock amounted to \$1.20 per share, paid in four equal quarterly installments of 30 cents each, compared with \$1.05 the prior year. Preferred shareholders received an aggregate of \$111,447 at the rate and on the dates specified in the issue.

Financial

The accelerated growth of the Company during the past year and its plans for the future have required considerable long-range financial planning. It was previously reported that 25,000 shares of 4 $\frac{3}{4}$ % convertible preferred stock were sold to institutional investors in 1954 to provide \$2,500,000 of the funds needed for additional working capital, fixtures and equipment. Since their issuance, 6,150 of these shares have been converted into common stock, thereby leaving 18,850 outstanding, convertible into 94,250 shares of common stock at some future date at the option of the holders.

In the latter part of the year, Red Owl Stores, Inc. acquired Hopkins Realty Company, a wholly-owned real estate subsidiary. The principal func-



tions of the subsidiary will be developing, holding, and leasing various store and warehouse locations to Red Owl. It is contemplated that Hopkins Realty Company will acquire properties and in turn sell mortgage bonds secured by the properties and the leases of Red Owl assigned to the purchaser of the bonds. Red Owl will not be a guarantor of the subsidiary's obligations.

It has been Red Owl's policy to build, sell, and lease back its properties upon completion of construction. Through the subsidiary, Red Owl can retain ownership of selected properties which otherwise would be subject to sale lease back arrangements with private or institutional investors.

In December, 1955 negotiations were concluded for the purchase of the main office and plant in Hopkins, Minnesota previously occupied by Red Owl under a lease agreement with Armour and Company Employees' Pension Fund. This resulted in the issuance of additional mortgage bonds by Hopkins Realty Company and provided net new funds approximating \$1,100,000 for working capital and equipment needs of the retail store expansion program. Ownership of this facility, also, will permit greater flexibility for probable structural additions to the plant in the future. An agreement between the subsidiary and an insurance company provides \$650,000 for such additions by means of stand-by funds which would be invested in an additional series of bonds for this purpose.

Also, under the terms of the financial agreement, the insurance company has agreed to loan the subsidiary an amount not to exceed \$1,250,000, at the option of the subsidiary over a two year period to finance its ownership of retail store land and buildings. Upon completion of building construction these properties will be leased to Red Owl by the real estate subsidiary.

Net working capital at the year-end was \$8,083,655, and the ratio of current assets to current liabilities was 2.19 to 1. Total inventories at the close of the year were \$9,672,573. An increase in the combined warehouse and retail store turnover rate was achieved during the year, due principally to the effect of better than average inventory turns in high volume stores.

At the balance sheet date, Red Owl had a temporary investment of about \$850,000 in real estate representing construction in progress, locations recently completed, and land acquired for future retail stores. This amount was not classified as a current asset, although it is anticipated that the major part will be recovered in the near future.

Funds invested in new fixtures and equipment during the year amounted to more than \$1,800,000.

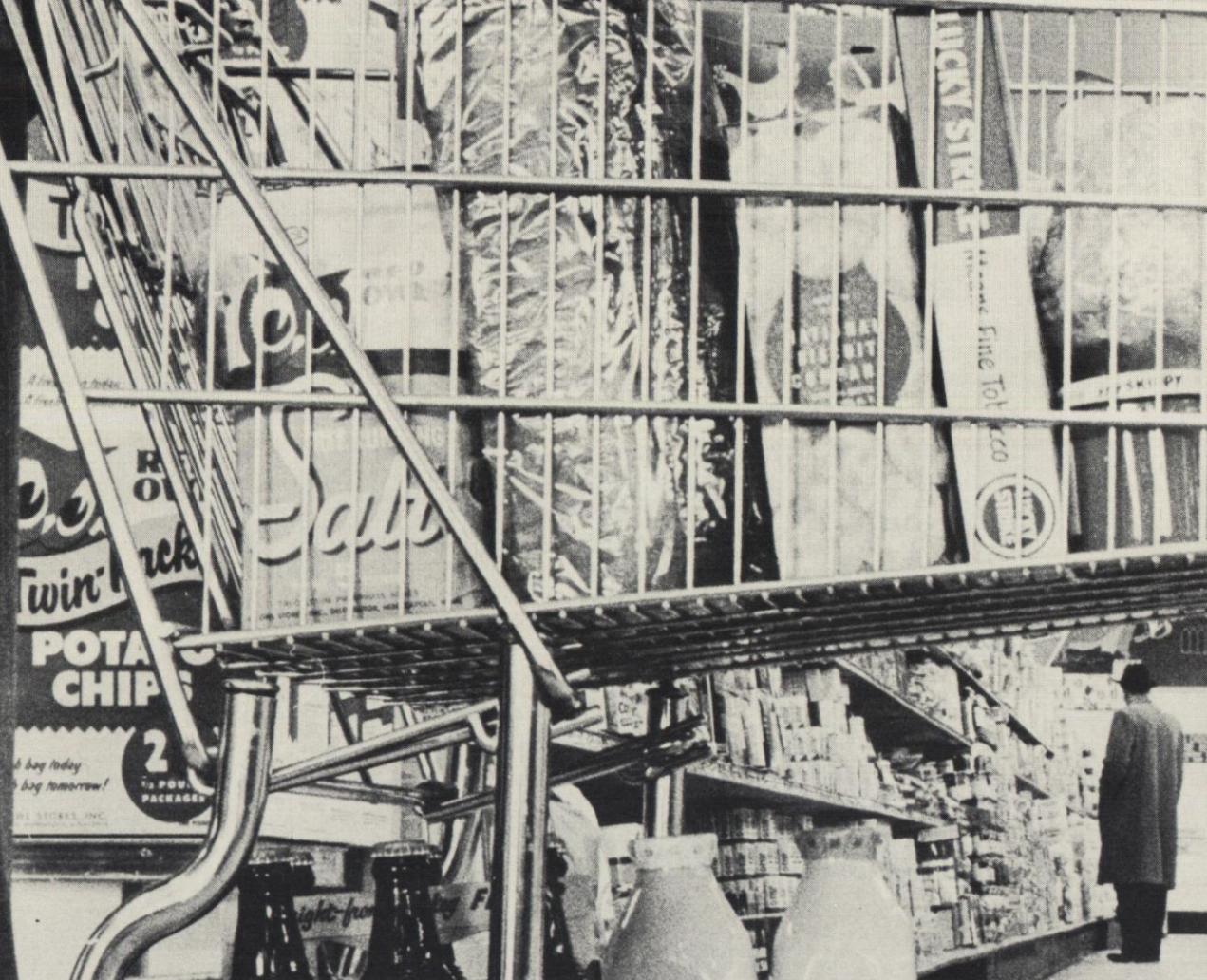
Personnel

At the outset of the expansion program, management recognized the important role of qualified people in the plans for the Company's future. In order to be prepared for the contemplated growth, development of manpower was intensified by means of recruiting, upgrading and training at various employee levels. Programs for executive, technical, and store personnel have been conducted both by instruction and on-the-job training. Special emphasis is constantly placed on providing courteous, friendly service to customers. Opportunities for advancement have presented themselves in many areas for qualified persons within the organization.

In the past year the Board of Directors elected W. J. Quinn to the position of Vice President, Michael J. McMahon, V. J. Winter and James A. Watson, Assistant Vice Presidents and L. W. Rixe, Treasurer. Also, Thomas R. Pellett, formerly associated with an investment banking firm, joined the organization as Assistant Treasurer.

The various incentive and compensation plans of the Company were reviewed during the year which resulted in some modifications. In addition





to revised pay plans, of particular benefit to employees was the extensive broadening of the coverage under the Company's voluntary participation group insurance plan.

Subject to ratification of the stockholders at the next annual meeting, the Board of Directors adopted a restricted Stock Option Plan for officers and key employees, excluding those officers who were Directors of Red Owl at the effective date of the plan. Approximately 6½% of the outstanding and reserved common shares were designated for this purpose and to the date of the accompanying balance sheet, 19,975 shares had been allocated under the plan.

Store Development Program

Objectives for the year called for developing about twenty supermarkets compared with the fourteen actually put into operation. However, additional stores were in varying stages of completion at the year-end to the extent that five locations, considered part of the year's program, had their grand openings in March, 1956, making a total of nineteen. Of these,

the familiar Red Owl trademark featured on the cover of this year's annual report made its appearance in thirteen new trade centers. The remaining six were replacements of existing but outmoded locations—where relocation in larger quarters with parking facilities appeared advisable to improve and solidify the Company's position in the market.

Following is a geographical summary of the aforementioned nineteen locations:

MINNESOTA

Austin
Marshall*
Twin City Metropolitan Area:
Crystal Village Shopping Center
Eastgate Shopping Center
Excelsior*
Knollwood Plaza Shopping Center
Lake Street at 22nd Avenue
Nicollet Avenue at 39th Street
Signal Hill Shopping Center

SOUTH DAKOTA

Yankton*

WISCONSIN

Appleton
Eau Claire
La Crosse
Merrill
Sheboygan
Sturgeon Bay*

NORTH DAKOTA

Bottineau*
Mandan*
Riverdale

*Denotes relocations

Modernization of present facilities continued during the year in those stores where relocation is not contemplated.



The Future

At the present time management plans for the ensuing year call for a store program of approximately twenty supermarkets, in addition to the five units opened in March, 1956 previously mentioned. Actual results will, of course, be contingent upon availability of property, favorable lease terms, and uninterrupted construction.

Generally speaking, the food industry has a favorable outlook in the year ahead according to acknowledged economic experts. Having modern facilities staffed with capable personnel, your Company will be prepared to attract its share of new customers and continue its friendly relationship with present patrons. Although competition in the food business is constantly becoming more intense, Red Owl's merchandising skills, its tradition of supplying outstanding, courteous service, coupled with added emphasis on internal controls, should result in another milestone of progress for the Company in the year ahead.

Highlights of the year's operations

We received from the sales of goods and services.....	\$123,753,056
We paid for merchandise, transportation, handling costs, rents, maintenance, and general operating expenses other than payrolls.....	\$108,382,937
We paid to our employees in wages and salaries and for other employee benefits including social security, retirement income and group insurance.....	\$11,998,525
We set aside for depreciation and amortization of fixed assets and leasehold improvements.....	\$801,969
We set aside for federal and state taxes on income.....	\$1,350,000
This left us as earnings.....	\$1,219,625

Out of These Earnings

We paid to our preferred stockholders as dividends.....	\$111,447
We paid to our common stockholders as dividends.....	\$598,231



How the sales dollar was divided



For merchandise,
transportation and
handling costs

87.6¢

For wages, salaries
and employee
benefits

9.7¢

For income
taxes

1.1¢

For depreciation
of buildings and
equipment

0.6¢

To
stockholders

0.6¢

Reinvested in
the business

0.4¢

Statement of Operations and Retained Earnings
RED OWL STORES, INC.

Year ended February 25, 1956 (with comparative figures for the previous year—Note 1)

	<i>Year ended February 25, 1956</i>		<i>Year ended Feb. 26, 1955</i>
	<i>Retail</i>	<i>Wholesale</i>	<i>Combined</i>
Net sales.....	\$95,073,867	28,679,189	123,753,056
Cost of goods sold, including warehousing and transportation expenses (Note 8).....	78,115,952	27,389,972	105,505,924
Gross profit on sales.....	<u>\$16,957,915</u>	<u>1,289,217</u>	<u>18,247,132</u>
Selling, general and administrative and other operating expenses (Notes 7 and 8).....			15,629,983
Operating earnings.....			<u>2,617,149</u>
Other income:			
Gain on sales of property and equipment.....		40,212	19,935
Miscellaneous income.....		<u>47,319</u>	<u>21,214</u>
		<u>87,531</u>	<u>41,149</u>
		<u>2,704,680</u>	<u>2,252,239</u>
Other charges:			
Interest { on long-term debt.....		110,050	116,250
{ other.....		20,481	24,812
Miscellaneous charges.....		4,524	64,295
		<u>135,055</u>	<u>205,357</u>
Earnings before taxes on income.....		2,569,625	2,046,882
Taxes on income, estimated:			
Federal.....		1,255,000	995,000
State.....		<u>95,000</u>	<u>68,000</u>
		<u>1,350,000</u>	<u>1,063,000</u>
Net earnings before special items.....		<u>1,219,625</u>	<u>983,882</u>
Special items—add (deduct):			
Provision for vacation pay, less related income taxes.....		—	(151,400)
Refunds and adjustments of prior years' income taxes.....		—	139,771
		—	(11,629)
Net earnings.....		1,219,625	972,253
Deduct:			
Dividends on Red Owl Stores, Inc. capital stock:			
4 3/4% convertible preferred stock.....		111,447	21,379
Common stock—\$1.20 and \$1.05 per share in respective years.....		<u>598,231</u>	<u>507,308</u>
		<u>709,678</u>	<u>528,687</u>
Expenses in connection with issue of 4 3/4% convertible preferred stock.....		—	53,170
		<u>709,678</u>	<u>581,857</u>
		<u>509,947</u>	<u>390,396</u>
Balance of retained earnings at beginning of year.....		<u>5,412,890</u>	<u>5,022,494</u>
Balance of retained earnings at end of year (Note 4).....		<u>\$ 5,922,837</u>	<u>5,412,890</u>

See accompanying notes to financial statements

Balance Sheet

RED OWL STORES, INC. February 25, 1956 (with comparative figures for the previous year—Note 1)

	ASSETS	Feb. 25, 1956	Feb. 26, 1955
Current assets:			
Cash	\$ 3,132,151	3,527,070	
Accounts receivable:			
Customers	843,994	949,322	
Equity in installment contracts sold (uncollected balances of accounts sold to banks \$97,165 and \$53,823 in respective years)	25,135	10,765	
Due from vendors, claims, etc.	211,343	265,926	
	<u>1,080,472</u>	<u>1,226,013</u>	
Less allowance for doubtful accounts	79,885	100,020	
	<u>1,000,587</u>	<u>1,125,993</u>	
Merchandise inventories, at lower of cost (first-in, first-out) or market, less \$285,000 reserve	9,672,573	8,268,088	
Prepaid expenses	413,273	242,432	
Properties subsequently sold or in process of sale (with agreements to lease back), less advance	633,903	36,479	
Total current assets	<u>14,852,487</u>	<u>13,200,062</u>	
Cash surrender value of life insurance	55,456	48,852	
Investment in subsidiary, Hopkins Realty Company	10,000	—	
Property, plant and equipment, at cost:			
Land	554,926	763,758	
Buildings	246,835	265,549	
Furniture, fixtures and equipment	6,342,928	5,143,542	
Automotive equipment	1,661,750	1,698,235	
	<u>8,806,439</u>	<u>7,871,084</u>	
Less depreciation	<u>3,802,841</u>	<u>3,503,651</u>	
Leasehold improvements, at cost less amortization	5,003,598	4,367,433	
Construction in progress	459,033	1,034,695	
	<u>168,944</u>	<u>76,631</u>	
	<u>5,631,575</u>	<u>5,478,759</u>	
Other assets	121,973	256,294	
	<u>\$20,671,491</u>	<u>18,983,967</u>	

LIABILITIES

Current liabilities:			
Current installments of long-term notes	\$ 240,000	240,000	
Drafts payable	297,445	178,860	
Accounts payable	3,721,971	2,899,328	
Accrued expenses	1,284,820	1,209,680	
Federal and State taxes on income, estimated	1,224,596	902,610	
Total current liabilities	<u>6,768,832</u>	<u>5,430,478</u>	
Provision for deferred income taxes (Note 8)	79,223	—	
Long-term 3 7/8% notes payable due July 1, 1966, payable in annual installments of \$240,000 on July 1 in each of the years 1957 through 1965 and unpaid balance on July 1, 1966, exclusive of current installments included above (Note 4)	2,520,000	2,760,000	
Stockholders' equity:			
Capital stock:			
Preferred stock—par value \$100 per share.			
Authorized 50,000 shares; issued and outstanding at respective dates, 18,850 and 25,000 shares, 4 3/4% convertible, Series A (Note 2)	1,885,000	2,500,000	
Common stock—par value \$3 per share.			
Authorized 750,000 shares; issued and outstanding at respective dates, 513,901 and 483,151 shares (Note 6)	<u>1,541,703</u>	<u>1,449,453</u>	
Additional amounts paid in by stockholders (Note 3)	3,426,703	3,949,453	
Retained earnings, per accompanying statement (Note 4)	1,953,896	1,431,146	
	<u>5,922,837</u>	<u>5,412,890</u>	
Long-term lease commitments (Note 9)	11,303,436	10,793,489	
	<u>\$20,671,491</u>	<u>18,983,967</u>	

See accompanying notes to financial statements

Statement of Operations and Retained Earnings

Red Owl Stores, Inc. and Realty Holding Subsidiary • Year ended Feb. 25, 1956

	<i>Red Owl Stores, Inc. (Note 1)</i>	<i>Hopkins Realty Company</i>	<i>Consolidated</i>
Sales and revenue:			
Net Sales.....	\$123,753,056	—	123,753,056
Rents received from parent company.....	—	77,500	—
	123,753,056	77,500	123,753,056
Cost of sales and operating expenses (Notes 7 and 8):			
Cost of goods sold, including warehousing and transportation expenses.....	105,505,924	—	105,454,947
Selling, general and administrative and other operating expenses.....	15,629,983	20,615	15,624,075
	121,135,907	20,615	121,079,022
Operating earnings.....	2,617,149	56,885	2,674,034
Other income.....	87,531	—	87,531
	2,704,680	56,885	2,761,565
Other charges:			
Interest:			
On long-term debt.....	110,050	27,651	137,701
Other.....	20,481	—	20,481
Miscellaneous charges.....	4,524	5,589	10,113
	135,055	33,240	168,295
Earnings before taxes on income.....	2,569,625	23,645	2,593,270
Taxes on income, estimated.....	1,350,000	8,400	1,358,400
Net earnings.....	1,219,625	15,245	1,234,870
Deduct dividends on Red Owl Stores, Inc. capital stock:			
4¾% convertible preferred stock.....	111,447	—	111,447
Common stock.....	598,231	—	598,231
	709,678	—	709,678
509,947	15,245	525,192	
5,412,890	—	5,412,890	
\$ 5,922,837	15,245	5,938,082	

See accompanying notes to financial statements

Balance Sheet • Red Owl Stores, Inc. and Realty Holding Subsidiary • February 25, 1956

Assets	<i>Red Owl Stores, Inc. (Note 1)</i>	<i>Hopkins Realty Company</i>	<i>Consolidated</i>
Current assets:			
Cash.....	\$ 3,132,151	267,362	3,399,513
Accounts receivable, less allowance for doubtful accounts.....	1,000,587	—	1,000,587
Merchandise inventories, at lower of cost (first-in, first-out) or market, less \$285,000 reserve.....	9,672,573	—	9,672,573
Prepaid expenses.....	413,273	528	413,801
Properties subsequently sold or in process of sale (with agreements to lease back), less advance.....	633,903	—	633,903
Total current assets.....	14,852,487	267,890	15,120,377
Cash surrender value of life insurance.....	55,456	—	55,456
Investment in realty holding subsidiary.....	10,000	—	—
Property, plant and equipment, at cost:			
Land.....	554,926	23,375	578,301
Buildings.....	246,835	2,640,188	2,887,023
Furniture, fixtures and equipment.....	6,342,928	—	6,342,928
Automotive equipment.....	1,661,750	—	1,661,750
Less depreciation.....	8,806,439	2,663,563	11,470,002
Leasehold improvements, at cost less amortization	3,802,841	19,801	3,822,642
Construction in progress.....	5,003,598	2,643,762	7,647,360
Accrued expenses.....	459,033	—	459,033
Construction in progress.....	168,944	—	168,944
Other assets.....	5,631,575	2,643,762	8,275,337
	121,973	30,493	152,466
	<u>\$20,671,491</u>	<u>2,942,145</u>	<u>23,603,636</u>
<i>Liabilities</i>			
Current liabilities:			
Current installments of long-term debt.....	\$ 240,000	94,500	334,500
Drafts and accounts payable.....	4,019,416	—	4,019,416
Accrued expenses.....	1,284,820	—	1,284,820
Federal and State taxes on income.....	1,224,596	8,400	1,232,996
Total current liabilities.....	6,768,832	102,900	6,871,732
Provision for deferred income taxes (Note 8).....	79,223	—	79,223
Long-term debt, less current installments included above:			
3 $\frac{7}{8}$ % notes payable due July 1, 1966, payable in annual installments (Note 4).....	2,520,000	—	2,520,000
Sinking fund mortgage bonds (Note 5):			
4% due June 1, 1969, Series A.....	—	790,000	790,000
4 $\frac{1}{4}$ % due March 1, 1970, Series B.....	—	391,500	391,500
4 $\frac{1}{2}$ % due December 1, 1975, Series C.....	—	1,632,500	1,632,500
4 $\frac{3}{4}$ %, Series D.....	—	—	—
Authorized and unissued \$650,000			
4 $\frac{3}{4}$ %, Series E.....	—	—	—
Authorized and unissued \$1,250,000			
Common stock of realty holding subsidiary.....	2,520,000	2,814,000	5,334,000
Stockholders' equity:			
Preferred stock—4 $\frac{3}{4}$ % convertible, Series A	—	10,000	—
Par value \$100 per share (Note 2).....			
Common stock			
Par value \$3 per share (Note 6).....	1,885,000	—	1,885,000
Additional paid-in capital (Note 3).....	1,541,703	—	1,541,703
Retained earnings (Note 4).....	1,953,896	—	1,953,896
Total stockholders' equity.....	5,922,837	15,245	5,938,082
Long-term lease commitments (Note 9).....	11,303,436	15,245	11,318,681
	<u>\$20,671,491</u>	<u>2,942,145</u>	<u>23,603,636</u>

See accompanying notes to financial statements

Notes to Financial Statements

Red Owl Stores, Inc. and Realty Holding Subsidiary

1. The accompanying financial statements of Red Owl Stores, Inc. for the year ended February 25, 1956 include the operations of a former active subsidiary, liquidated into Red Owl Stores, Inc. December 31, 1955, for the ten months then ended and thus are comparable with the consolidated financial statements of Red Owl Stores, Inc. and subsidiaries for the year ended February 26, 1955. (The investment in a minor inactive subsidiary consolidated at February 26, 1955 has been included in "Other Assets" at February 25, 1956).

2. The 4 $\frac{3}{4}$ % convertible preferred stock, Series A, is redeemable on call or on voluntary liquidation at \$105 a share to September 30, 1959; the redemption premium decreases thereafter until September 30, 1972 after which the stock is redeemable at par. The Company is required to call for redemption at \$100 a share plus accrued dividends 2% of the greatest number of shares outstanding during the year (less the number of shares converted into common stock during the year) on October 1 of each of the years 1959 through 1963 and 5% on October 1 of each year thereafter.

Shares of such preferred stock (taken at \$100 a share) are convertible into common stock at \$20 a share until September 30, 1964, after which conversion privileges expire. In connection with the foregoing, 94,250 shares of unissued common stock are reserved for issuance upon conversion of preferred stock.

3. Additional amounts paid in by stockholders during the year ended February 25, 1956 amounting to \$522,750 represent the excess of the conversion price over the par value of 30,750 common shares issued on conversion of 6,150 shares of 4 $\frac{3}{4}$ % convertible preferred stock, series A.

4. Restrictions on payment of dividends (except stock dividends) and purchase, redemption or retirement of common stock are imposed by terms of the preferred stock agreement. The amount free from such restrictions at February 25, 1956 was \$1,382,000. In view of the foregoing, similar restrictions imposed by the 3 $\frac{1}{8}$ % note agreements are not applicable.

The 3 $\frac{1}{8}$ % note agreements, among other things, provide for pre-payment of the long-term debt at the option of the Company at varying premiums.

5. Sinking fund mortgage bonds were issued or assumed by a wholly-owned realty holding subsidiary in connection with the acquisition by that subsidiary of the Company's principal warehouse property. The mortgage bonds issued or assumed are secured by the warehouse property and the subsidiary's interest in a thirty year lease made by the realty holding subsidiary to the Company.

Sinking fund payments are required to retire, without premium, bonds presently outstanding aggregating \$94,500 in fiscal year 1957, approximately \$155,000 a year from 1958 through 1969, decreasing annual amounts through 1975 and unpaid balance in fiscal year 1976. The Company, at its option, may make additional sinking fund payments without premium, at dates and in amounts specified by the terms of the mortgage indenture, and may redeem bonds after specified dates other than through operation of the sinking fund at varying premiums.

The realty subsidiary has received commitments from the holders of the presently outstanding mortgage bonds to purchase, within specified periods, the unissued series D and E bonds. Until bonds of these series have been issued or the commitments have been terminated, the realty holding subsidiary is obligated to pay a quarterly fee at the rate of $\frac{1}{2}\%$ per annum on the aggregate unissued principal amount.

6. An Employees' Stock Option Plan was adopted by the Board of Directors of the Company on December 28, 1955,

subject to ratification by the stockholders at their next meeting. Pursuant to such plan, stock options were granted on January 11, 1956 to 31 executive employees to purchase 19,975 shares of the Company's common stock at a price of \$24 a share, which was slightly more than 95% of the quoted market price on the date of grant. Options for 20% of the number of shares granted become exercisable during each year of a five-year period commencing January 11, 1957, subject to earlier expiration in the event of termination of employment.

The Company has reserved 40,000 shares of its authorized and unissued common stock for issuance under the Employees' Stock Option Plan at not less than 95% of the fair market value of the stock at the dates the options are granted. Under terms of the plan, no more than that number of shares may be made subject to option.

7. Pension and profit sharing costs included in selling, general and administrative and other operating expenses are as follows:

	<i>Year ended</i>	<i>Feb. 25, 1956</i>	<i>Feb. 26, 1955</i>
Employees' profit sharing	\$188,200	214,843	
Pension premium costs	234,000	219,870	

The pension plan is a non-contributory plan which is qualified under the Internal Revenue Code and provides retirement benefits for eligible employees.

8. Depreciation and amortization expenses included in costs and expenses are summarized as follows:

	<i>Year ended</i>	<i>Feb. 25, 1956</i>	<i>Feb. 26, 1955</i>
Red Owl Stores, Inc.	\$801,969	711,480	
Hopkins Realty Company	19,801	—	
Total	\$821,770	711,480	

Depreciation on additions to fixtures and equipment acquired since January 1, 1954 for tax purposes has been computed by one of the accelerated methods of depreciation permitted by the Internal Revenue Code of 1954. For general accounting purposes, depreciation has been computed by the straight-line method as in previous years. Provision has been made by charge against current earnings for deferred income taxes relating to the excess of depreciation to be claimed for tax purposes over the corresponding depreciation charged against earnings.

9. Long-term leases, excluding the lease to the Company by the realty holding subsidiary described below, expiring more than three years after February 25, 1956 establish minimum annual rentals on 85 stores and 2 warehouses. The approximate minimum annual rentals under such leases, excluding taxes, insurance, or maintenance costs payable by the Company, amount to \$942,000. Of this amount, leases with minimum annual rentals of \$160,000 expire within five years and leases with minimum annual rentals of \$782,000 have terms extending from five to twenty years from that date.

In addition, the Company has entered into agreements to lease store properties at new locations for initial periods of twelve to fifteen years at minimum annual rentals which will aggregate approximately \$95,000.

A wholly-owned subsidiary, Hopkins Realty Company, acquired during the year, purchased the Company's principal warehouse and home office site. The Company has leased this property from its realty holding subsidiary for an initial period of thirty years at a present minimum annual rental of \$310,000. Rents paid to the realty holding subsidiary have been eliminated in the consolidated figures which include depreciation and interest expense of that subsidiary.

Directors

1. FORD BELL
Chairman of the Board of Directors,
Red Owl Stores, Inc.*
2. ALF L. BERGERUD
*Vice President,
Red Owl Stores, Inc.*
3. JOHN C. CORNELIUS
*Honorary Director,
Batten, Barton, Durstine & Osborn, Inc.*
4. JOHN Y. DEAR
*Retired As Vice President,
Red Owl Stores, Inc. October 1, 1955*
5. GLENN R. GRIFE
President,
Red Owl Stores, Inc.*
6. RICHARD L. KOZELKA
*Dean, School of Business Administration,
University of Minnesota*
7. JOSEPH F. RINGLAND
*President, Northwestern National
Bank of Minneapolis*
8. HENRY C. STEPHENSON
Financial Consultant
9. H. J. WORRELL
*Vice President,
Red Owl Stores, Inc.*

Accountants' Report

PEAT, MARWICK, MITCHELL & CO.

Certified Public Accountants,
Northwestern Bank Bldg., Minneapolis 2, Minnesota

The Board of Directors
Red Owl Stores, Inc.:

We have examined the balance sheets of Red Owl Stores, Inc. and of its realty holding subsidiary as of February 25, 1956 and the related statements of operations and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheets and statements of operations and retained earnings present fairly the financial position of Red Owl Stores, Inc. and its realty holding subsidiary at February 25, 1956 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

PEAT, MARWICK, MITCHELL & CO.

Minneapolis, Minnesota

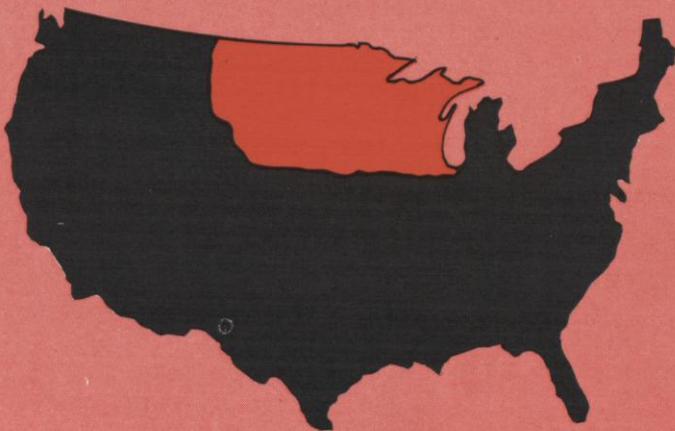
April 16, 1956

Officers

- FORD BELL
*Chairman of the Board of Directors**
- GLENN R. GRIFE
*President**
- ALF L. BERGERUD
Vice President
10. W. J. QUINN
Vice President
11. ERLING RICE
Vice President
- H. J. WORRELL
Vice President
12. L. W. RIXE
Treasurer
13. J. T. SYDNES
Secretary and Assistant Treasurer
14. F. D. SCOTT
Controller
15. MICHAEL J. McMAHON
Assistant Vice President
16. JAMES A. WATSON
Assistant Vice President
17. V. J. WINTER
Assistant Vice President
18. THOMAS R. PELLETT
Assistant Treasurer
19. A. L. NORDSTROM
Assistant Secretary
20. R. H. WHITE
Assistant Secretary

*Giving effect to changes as of March 9, 1956

Red Owl now operates 143 corporate retail stores in nine states. The majority are located in Minnesota, the Dakotas and Wisconsin, however, 504 Agency stores are included in the operating territory, with three main warehouses and a sub-warehouse which is maintained in Rapid City, South Dakota.



	IOWA	MICH.	MINN.	MONT.	NEB.	N. DAK.	S. DAK.	WIS.	WYO.
CORPORATE STORES	3	9	47	2	1	31	24	25	1
AGENCY STORES	2	24	214	3		89	37	135	
MAIN WAREHOUSES			1			1		1	

Five Year Statistical Summary

Red Owl Stores, Inc.
(Excluding Real Estate Subsidiary)

FISCAL YEAR ENDED IN	1956	1955	1954	1953	1952
Sales					
Retail	\$ 95,073,867	\$ 80,801,336	\$ 77,063,837	\$ 67,344,759	\$ 65,340,696
Wholesale.....	28,679,189	31,378,119	29,723,336	27,744,179	24,493,197
Total.....	\$123,753,056	\$112,179,455	\$106,787,173	\$ 95,088,938	\$ 89,833,893
Earnings before taxes on income	2,569,625	2,046,882	1,430,100	1,585,929	1,720,269
Net earnings for year.....	1,219,625	972,253*	680,100	745,929	732,269
Preferred dividends paid.....	111,447	21,379	24,097	42,265	55,459
Net earnings applicable to common equity.....	1,108,178	950,874	656,003	703,664	676,810
Common stock dividends paid.	598,231	507,308	458,536	432,067	413,340
Net earnings for year retained in business.....	509,947	390,396	197,467	271,597	263,470
Net earnings per share common	2.17	1.93*	1.43	1.54	1.63
Dividends per share common..	1.20	1.05	1.00	1.00	1.00
Current assets.....	14,852,487	13,200,062	11,238,304	10,596,654	10,179,162
Current liabilities.....	6,768,832	5,430,478	5,100,594	4,405,043	3,990,964
Net working capital.....	8,083,655	7,769,584	6,137,710	6,191,611	6,188,198
Ratio of current assets to current liabilities.....	2.19 to 1	2.43 to 1	2.20 to 1	2.41 to 1	2.55 to 1
Stockholders' equity.....	11,303,436	10,793,489	8,026,465	7,829,066	7,558,564
Book value per share common.	18.11	16.87	16.32	15.89	15.29
Shares outstanding					
Preferred.....	18,850	25,000	4,934	5,239	11,471
Common.....	513,901	483,151	459,590	457,688	414,884
Number of common shareholders.....	2,291	2,161	1,998	1,777	1,370
Number of stores at close of year					
Retail.....	143	145	151	162	179
Agency.....	504	556	551	562	559
Average retail sales per location	665,000	557,000	510,000	415,000	365,000
Number of employees (including part time).....	3,850	3,400	3,350	3,200	3,100

*After special charge of \$11,629.



RED OWL



A BRIGHT LANDMARK in Minneapolis—the giant new Red Owl supermarket with its illuminated tower at Lake St. and 22nd Ave.

For more information about the activities and policies of Red Owl Stores, write to . . .

RED OWL STORES, INC.
HOPKINS, MINNESOTA

*Executive offices: 215 E. Excelsior Avenue, Hopkins, Minn.
Mailing Address: Post Office Box 1128, Minneapolis, Minn.
Stock Transfer Agent: Northwestern National Bank of
Minneapolis. Auditors: Peat, Marwick, Mitchell & Co.*

